

Bankruptcy Code: Must not allow recalcitrant creditors to hold system to ransom

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History, scriptures and literature compels us to support the harassed borrower in his transactions with an oppressive money lender. Tables have turned today and there is growing support for banks in their efforts to recover dues from borrowers. Shakespeare's Merchant of Venice and Jimmy Stewart's It's a Wonderful Life would be very different in an era of rising NPAs and wilful defaulters.

India ranks a lowly 136 among 184 countries on insolvency resolution parameter according to the World Bank's Doing Business Report 2016. This does not augur well for a destination that seeks investments. Whatever the morality, the sheer economics of unpaid loans warrants urgent action. Apart from NPAs due to banks, companies litigate extensively on monies due from non-financial debtors.

An environment of legal uncertainty and high litigation costs coupled with legal and economic paradoxes has resulted in a situation where creditors may be dissuaded from initiating recovery proceedings.

Current laws

Prior to the Insolvency and Bankruptcy Code, nearly half a dozen laws covered the spectrum of debt recovery from the simple law of contract to the specialised and fairly powerful Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Sarfaesi Act). These include laws related to recovery of debts to banks and financial institutions, companies and winding up proceedings, sick companies, public and other statutory financial corporations, and other honourable mentions like workmen, tenants and arbitration. If the law relating to recovery of money wasn't complicated enough with parallel and multiple proceedings, another aspect that complicates recovery of debt is the hierarchy of debt—which generally places the government of India at the top and unsecured creditors right at bottom. The complex web of laws, multiple characters involved in debt recovery proceedings, desperate pleas of debtors and creative lawyering has resulted in protracted proceedings which defeat the exercise of money recovery and winding up.

While it is easy to blame the system, it is important to note that courts have tried to balance rights of debtors, including its stakeholders, on the one hand, and creditors on the other. For instance, in 2016, the Supreme Court had to consider rights of a tenant caught in the cross-fire of debt recovery proceedings. After years of litigation, the Supreme Court set aside the proceedings since rights of the creditor under Sarfaesi were held to be subordinate to those of a tenant—a protected class of persons under laws of a state (*Vishal N Kalsaria vs Bank of India & Ors*). While the law does not provide for it always, the Supreme Court has read into the provision of debt recovery laws a mandatory requirement of compliance with principles of natural justice. In a 2014 ruling, a protracted litigation under Sarfaesi was set at naught because notice of sale was not given to the debtor (*Mathew Varghese vs M Amritha Kumar*).

The ecosystem

India lacked an ecosystem that encouraged dismantling of companies and sale of its divisions. In the movie *Pretty Woman*, Richard Gere's character, Edward Lewis, says, "I don't sell the whole company; I break it up into pieces ... and then I sell that off; it's worth more than the whole." For various reasons, in India, legal proceedings do not appear to corroborate this principle. Research relied on the Bankruptcy Law Reforms Committee chaired by TK Vishwanathan shows courts have generally been disinclined to dismantle companies, preferring rehabilitation instead. As a consequence, there may be economic paradoxes where economically viable units are

uneconomically utilised, defeating the objective of debt recovery and rehabilitation laws.

Some of the reasons for these failures were addressed by the Vishwanathan Committee and the Bankruptcy Code seeks to address these issues of uncertainty and unpredictability.

Bankruptcy code

Rule of law requires that a law should be certain, predictable and consistent and by resolving multiple laws, the Bankruptcy Code seeks to achieve this. Materially, these include winding up proceedings under company law and revival of sick companies. The Bankruptcy Code also seeks to put in place a time-line for an expeditious resolution of recovery claims. However, India's experience with time-bound litigation has not been good—unless there are court mandated hearings every day, statutory time-lines are generally not adhered to. The Bankruptcy Code's resolution mechanism for debts which are not financial debts (i.e. monies borrowed) should help trade creditors who are unsecured and often caught in the cross-fire of multiple proceedings.

But if the adjudicating authority finds an arbitrable dispute, the creditor will find itself at the bottom of the ladder—with the task of having to first succeed in its legal dispute on the legitimacy of the claim. This would not prevent aggressive trade creditors from trying to take advantage of the Bankruptcy Code to apply pressure even in cases of disputed claims. Various high courts have ruled that winding up proceedings under company law cannot be used to recover money or to coerce a party to settlement. Unlike the Companies Act of 1956 which required a company to be 'unable' to pay its debt, the Bankruptcy Code has no such requirement. In respect of financial debts, the Bankruptcy Code empowers the adjudicating authority to take 14 days for a determination of a default. But there is no provision for prior notice to the debtor and this may be an issue for litigation.

It is important that recalcitrant creditors do not hold a company and the system to ransom and the Bankruptcy Code leaves this to the discretion of the adjudicating authority.

Insolvency professionals

They have an important role in providing an ecosystem for revival of companies and the Bankruptcy Code empowers insolvency professionals with powers of management of the debtor company. A crucial aspect of the Bankruptcy Code is to ensure the success of a company and only time would tell to what extent insolvency professionals are able to achieve what the Board for Industrial and Financial Reconstruction could not. Based on international experience, it is important

that insolvency professionals do not replace management and board of directors of a company. It would also be important to ensure that insolvency professionals do not add to the cost of recovery proceedings.

Dealing with uncertainty

Will the Bankruptcy Code succeed where existing laws have failed? As Rajendra Prasad observed in the context of the Constitution of India, a law is only as good as the people who make up the system. Financial sickness is an economic condition and it would be naive to believe that laws will suddenly put an end to financial woes of companies. If one examines international success stories in revival of a company—such as Chrysler or Nissan—it takes a combination of financial, operational and economic decisions. It is a moot point whether insolvency professionals would be best suited for such a role or whether management is better left to the board of directors with the guidance of an insolvency professional. It is imperative that courts refuse to entertain objections on economic and operational matters which an insolvency professional takes.

Will the Bankruptcy Code prevent a situation like Kingfisher? The Bankruptcy Code is not a check on the management of a company and isn't a measure to prevent companies from taking bad commercial decisions or occurrence of an economic downturn. It is equally important for courts to not view every debt default as a criminal act, as denial of funds during hardship is what companies may need to tide over short crises. After all, it would have been a criminal denial of due process to presume that Antonio's default to Shylock was wilful.

However, one can hope that the Bankruptcy Code clears the unpredictability on recovery and, unlike Schrödinger's cat, there is no uncertainty on the condition of the money.

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